

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION INTO THE FINANCIAL)	
CONDITION OF WHITLEY COUNTY WATER)	CASE NO.
DISTRICT NO. 1)	89-364

O R D E R

Whitley County Water District No. 1 ("Whitley County") is experiencing severe problems servicing its long-term debt. On August 1, 1961, it issued \$400,000 of water revenue bonds which mature serially on August 1, 1964 through August 1, 1991. To date, no interest or principal on these bonds has been paid. As of June 30, 1989, outstanding principal and accrued interest on these bonds stood at \$928,910. This failure to pay its bonded debt led a federal district court on August 27, 1985 to place the water district into receivership.¹

When Whitley County sought a rate increase in 1988, the Commission expressed its concern about the water district's mounting debt and inability to make payments on the bond principal.² It ordered Whitley County to submit a detailed plan

¹ Alvis v. Witt, No. 82-95 (E.D. Ky.).

² Case No. 10235, The Application of Whitley County Water District for a Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities.

for paying or refinancing its long-term debt, including accrued interest, and to submit semi-annual reports on the implementation of this plan.

On November 29, 1989, Whitley County submitted a debt service plan. Under this plan, the funds allocated monthly for debt service are determined by deducting monthly expenses, excluding interest expense, from monthly revenues. One half of the remaining revenue is deposited in a special interest-bearing account marked for debt service. Should monthly expenses exceed monthly revenues, no funds are allocated.

The Commission has three major concerns about this plan. First, it fails to comply with the Commission's Order of October 26, 1981 in Case No. 8220,³ wherein Whitley County was ordered to deposit \$22,340 annually into a special interest-bearing account to be used solely for debt service. As that Order has never been revoked or modified or suspended by the Commission, it is still in force in accordance with KRS 278.390. Whitley County's plan offers no assurance that this amount will be set aside. In fact, it does not guarantee that any funds will be set aside nor does it specify a minimum amount to be devoted to debt service. Under the

³ Case No. 8220, The Application and Petition of the Whitley County Water District No. 1 for an Order Authorizing the Water District to Revise Rates, to Initiate a Metering Program to Begin Metering all Customers, for a Purchase Water Adjustment Clause, and for a Waiver by This Commission Permitting the Filing of This Application and the Processing of This Case Based upon Financial Statements for the Period Ending December 31, 1980.

plan, the amount of funds for debt service is totally dependent on the level of non-interest expenses. No limit is placed on the amount of expenses. Such expenditures are given priority over debt service.

Second, the plan allocates significantly less to debt service than the Commission did when establishing Whitley County's current rates. In Whitley County's last rate case, the Commission averaged the last four years of Whitley County's bond amortization schedule and determined its annual debt service requirement to be \$39,919. Using a 1.2x debt service coverage, the Commission established rates for service that included approximately \$48,000 for debt service.⁴ During the first nine months in which the debt service plan has been in effect, less than one quarter of that amount has been allocated to debt service. This fact strongly suggests that Whitley County is incurring expenses at a level the Commission has found imprudent and unreasonable.

Finally, the plan has thus far failed to work. It does not allocate sufficient funds to cover current interest payments on the water revenue bonds, much less to reduce bond principal and accrued interest. Between December 31, 1988 and June 30, 1989, for example, Whitley County allocated \$4,586.70 to debt service. During the same period, it accrued an additional \$11,170 in interest on its water revenue bonds.⁵

⁴ 1.2 x \$39,919 = \$47,903

⁵ Letter from Thomas R. Gambrel to Forest M. Skaggs (August 30, 1989) (discussing Whitley County's debt retirement).

A utility's credit rating is critical to the quality and price of its service. To expand and improve service, a utility requires capital. For a water district, capital is raised solely through the issuance of debt. A water district with a history of solid and reliable debt service is better able to attract lenders and to acquire capital at lower costs. On the other hand, a water district with a poor credit history must pay higher rates of interest to attract lenders and pass that higher cost of capital on to its customers in the form of higher rates for utility service.

Because Whitley County has yet to develop a plan to successfully service its debt and to comply with previous Commission Orders, the Commission finds that an investigation into the financial condition of Whitley County should be conducted. It further finds that this investigation should focus primarily on Whitley County's debt service problems and the potential solutions thereto.

IT IS THEREFORE ORDERED that:

1. Pursuant to KRS 278.250, an investigation into the current financial condition of Whitley County is hereby commenced.
2. A hearing shall be held on May 15, 1990 at 10:00 a.m., Eastern Daylight Time, in Hearing Room No. 1 of the Commission's offices at 730 Schenkel Lane, Frankfort, Kentucky, for the purpose of taking evidence and hearing testimony on Whitley County's debt service problems and potential solutions thereto.

3. Whitley County shall make available for inspection and examination by the Commission and its employees all its books, accounts, papers, and records.

Done at Frankfort, Kentucky, this 21st day of December, 1989.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman

Commissioner

ATTEST:

Executive Director